LOCAL GOVERNMENT FINANCE IN THE BAY AREA

A Background Paper

Prepared by

THE ASSOCIATION OF BAY AREA GOVERNMENTS

for the

HEARING ON LOCAL GOVERNMENT FISCAL PROBLEMS

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A BACKGROUND PAPER

LOCAL GOVERNMENT FINANCING STUDY
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Douglas G. Detling, Senior Administrative Officer
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INTRODUCTION

Fundamental questions have been raised throughout the country about the ability of local government revenue systems to raise adequate revenues for urban services. There are obvious differences among communities in the type and level of public services that their citizens demand. Local policy makers believe that there are also wide disparities among local governments in their capacities to raise money to provide expected services.

California's Property Tax Relief Act of 1972 (SB 90) placed limitations on the ability of local governments to raise revenue through increases in the property tax rate. All cities and counties had a choice of using either the 1971-72 or the 1972-73 property tax rate as their maximum. Except for certain specified situations (e.g., court mandated costs, debt service, etc.), a jurisdiction cannot raise the property tax rate above this limit without voter approval. In fiscal year 1975-76 it was estimated that 112 California cities levied the maximum allowable property tax rates. Seventeen of these cities were in the Bay Area.

When the revenue-raising capacity of a jurisdiction is not sufficient to support needed services, local officials look for new sources of revenue that will not increase the taxes paid by their constituents. Consequently, there is tremendous competition among local governments to secure new industrial and commercial development. Local governments perceive that such developments generate more tax revenue than it costs to provide public services. This competition often results in adverse environmental effects and inefficient urban development.

Discussions of local government finance in the current legislative session include proposals to provide:

- tax relief measures based on personal income levels (circuit breakers)
- equalization of expenditures or revenue-raising capacity of school districts to comply with the State Supreme Court's Serrano decision[1]
- separate (or split) rolls for commercial-industrial and residential property and differential tax rates
- property tax revenue limits
- optional local revenue sources
- shifting a greater portion of health and welfare costs to the State
- sufficient State reimbursements for local services mandated by the Legislature

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[1] Serrano v. Priest, 5 Cal. 3d 584, 487 P.2d. 1241 (1971)

Although this background paper and hearing are not intended to provide information for the current legislative debates, it is important to recognize that local governments' fiscal problems may be aggravated if they are further restricted in their ability to raise revenues. The Legislature may enact property tax revenue limits without alternative revenue sources. This would undoubtedly result in local governments seeking alternative methods of financing urban services.

The California Supreme Court in its Serrano decision concluded that education is a "fundamental right" that should not be a function of a district's local wealth. The court specifically avoided the question of whether its logic could be applied to other governmental services. Some people believe that California may in the future apply the basic logic of the school finance decision to other "fundamental" services -- such as police and fire protection, although there is obviously considerable debate on this point.[2]

Another method of gaining new revenue for some Bay Area local governments has been suggested by the Board of Supervisors of the City and County of San Francisco. In December 1976 the Board adopted a resolution requesting the Association of Bay Area Governments to undertake a study of tax sharing. The ABAG Executive Board decided to examine tax sharing proposals as part of a broader review of alternatives for financing local government services in the Bay Area.

This report outlines some major issues and alternatives. The report also serves as a background paper for a hearing sponsored jointly by ABAG and the Institute of Governmental Studies of the University of California at Berkeley. The purpose of the hearing is to allow local elected officials and interested citizens to focus on the problems of local government finance in the Bay Area.

[2]For example, an analysis of this issue, Municipal Services and the Serrano Decision, (presented in April to the League of California Cities' Board of Directors) supports the argument that it is inappropriate to apply the Serrano logic to municipal services.

LOCAL GOVERNMENT FISCAL STRUCTURE IN THE BAY AREA

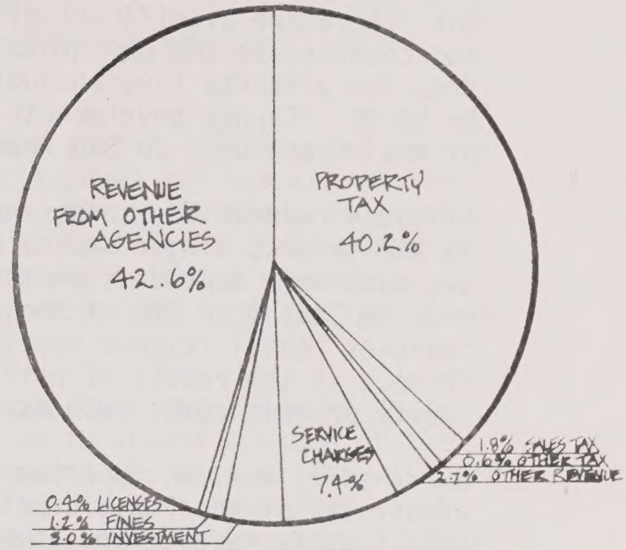
In fiscal year 1975-76, the cities and counties in the Bay Area raised or received a total of $2.6 billion in revenue to support local public services. The largest share of this revenue (46%) was raised by the eight county jurisdictions (excluding San Francisco) in the region. Total revenue by the counties amounted to $1.2 billion. The region's 92 city governments raised $832 million (32%). Revenue for the combined City and County of San Francisco was $578 million (22%).

The sources of local government revenue can be classifed into seven general categories:

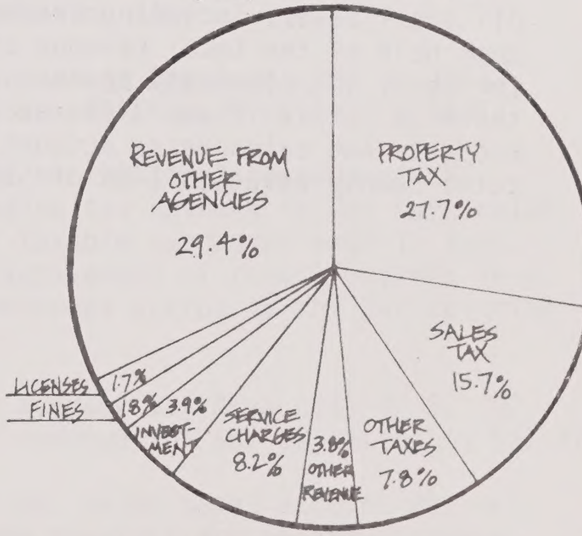
- Taxes (e.g., property, sales)
- Licenses and permits (e.g., construction, parking)
- Fines and penalties (e.g., vehicle code)
- Income from investment (e.g., interest, rents)
- Revenue from other agencies (e.g., Federal grants, State subventions)
- Current service charges (e.g., zoning fees, sewer service, library fines)
- Other revenue (e.g., sewer connection fees, sale of city-owned property)

It is often useful to further dis-aggregate the tax category into three major components: property taxes, sales taxes, and other taxes. The charts at right show local government revenues by source for all cities and counties in the Bay Area. For consistency, State property tax relief payments are included with property tax revenues.

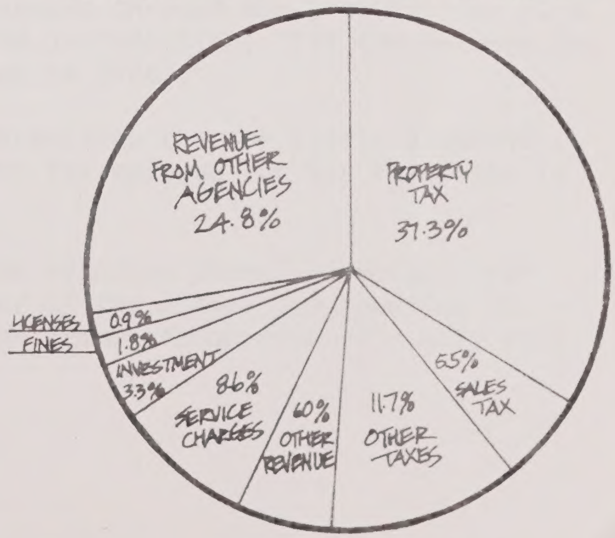
BAY AREA COUNTIES



BAY AREA CITIES



CITY & COUNTY OF SAN FRANCISCO



City and county governments each rely on revenues from all of the categories, but there are significant differences in the revenue structure of the cities and counties in the Bay Area. The cities derive 28% of their total revenue from the property tax, including State property tax relief payments authorized by SB 90. County governments depend on the property tax for more than 40% of their revenue. In San Francisco, 37% of the revenue is from property tax.

Although revenue from other agencies (e.g., Federal grants, State subventions) is the largest single source of local government funds, the region's counties are much more dependent on this source than its cities. City governments receive less than 30% of their total revenue from other agencies, while 43% of counties' total revenue comes from this source. However, much of this difference is the result of partial State and Federal assumption of mandated county program costs such as welfare expenditures.

Local sales tax, an important source of revenue for cities, contributed almost 16% of total municipal revenue. Sales tax accounted for only 2% of total county revenue and 6% of San Francisco revenue.

All local taxes, including property, sales, and other taxes, provide more than half of the total revenue of Bay Area cities while this source accounts for about 43% of county revenues. But for property and sales taxes alone, there is little if any difference between the region's cities and counties. Property and sales taxes account for 43% of total city revenues and 42% of total county revenues (43% of San Francisco revenue).

LOCAL GOVERNMENT FISCAL CAPACITY IN THE BAY AREA

Local government fiscal capacity refers to the ability of city and county governments to raise revenues. Fiscal capacity does not compare current revenue totals because these are highly dependent on the needs of local citizens. Rather, fiscal capacity is a set of "policy neutral" measures designed to estimate the ability of jurisdictions to raise revenues regardless of the type or level of public services the local jurisdictions independently choose to provide.

Cities and counties in the Bay Area obtain more than one-third of their total revenue from the property tax. Thus, an important measure of the fiscal capacity of a jurisdiction is the property tax base or the assessed valuation. Of course, total assessed valuation is most dependent on the size of the jurisdiction. But per capita assessed value provides a better measure of fiscal capacity, or the ability to finance public services, since it is independent of the local population size.

The per capita assessed valuation of the average Bay Area city is $6263. The median fiscal capacity from property tax for the 92 cities is $4317.

Sales taxes account for approximately 16% of the total revenue of the region's cities. The actual amount of sales tax revenue in any particular jurisdiction is related to the amount of taxable purchases made in that community. The number and relative attractiveness of retail outlets in a community is important since sales tax revenues accrue to the jurisdiction in which a sale is made.

The per capita sales tax revenue for the average Bay Area city is $51.92. However, the median per capita sales tax revenue for the 92 cities is $31.17.

In the Bay Area counties, unlike the cities, sales taxes account for only 2% of the total county revenue. Thus, the counties are relatively more dependent than the cities on the local property tax. Of course, the ability of county governments to raise local revenues through the property tax is a function of the assessed valuation of the jurisdiction. For the average Bay Area county the per capita assessed value is $4267.

In the combined City and County of San Francisco the per capita assessed valuation is $4672. The per capita sales tax revenue for San Francisco is $48.09.

The chart on the following page shows the relative fiscal capacity (both assessed valuation and sales tax revenue) of the cities and counties in the Bay Area. The City and County of San Francisco appears as a city only.

FISCAL CAPACITY

PER CAPITA ASSESSED VALUATION FOR BAY AREA CITIES*

126,391 HERCULES

21 COLMA (21,795)

17 EMERYVILLE (17256)

11 BELVEDERE (11316)

10 HILLSBOROUGH (10,318)

SAUSALITO (9425)
9 ATHERTON (9145)

ROSS (8463)
PALO ALTO (8114)
BENICIA (8726)
WOODSIDE (8267)
8

BRISBANE (7401)
BURLINGAME (7251)
LOS ALTOS HILLS (7452)
TIBURON (7263)
7 MENLO PARK (7249)

ST. HELENA (6659)
PIEDMONT (6154)
MONTE SERENO (6033)
CUPERTINO (6711)
RICHMOND (6165)
6 S.S.F. (6149)

CORTE MADERA (5776)
SAN LEANDRO (5739)
PORTOLA VALLEY (5594)
SARATOGA (5441)
LAFAYETTE (5373)
SANTA CLARA (5126)
SAN RAFAEL (5903)
SAN CARLOS (5765)
LOS ALTOS (5705)
MILL VALLEY (5577)
WALNUT CREEK (5389)
MOUNTAIN VIEW (5299)
5 LARKSPUR (5086)

SUNNYVALE (4978)
MILLBRAE (4825)
MORAGA (4798)
CAMPBELL (4624)
FOSTER CITY (4445)
SAN ANSELMO (4382)
UNION CITY (4137)
HAYWARD (4101)
LOS GATOS (4933)
MARTINEZ (4866)
CLAYTON (4803)
SAN FRANCISCO (4672)
SAN MATEO (4591)
REDWOOD CITY (4421)
HALF MOON BAY (4252)
4 MORGAN HILL (4113)

FAIRFAX (3899)
PLEASANTON (3823)
SAN BRUNO (3631)
OAKLAND (3610)
ALBANY (3501)
NEWARK (3444)
BERKELEY (3394)
GILROY (3295)
SEBASTOPOL (3275)
BELMONT (3990)
SANTA ROSA (3866)
NOVATO (3655)
SONOMA (3625)
FREMONT (3567)
PLEASANT HILL (3507)
EL CERRITO (3463)
SAN JOSE (3441)
CONCORD (3339)
MILPITAS (3280)
3 HEALDSBURG (3190)

ALAMEDA (2885)
COTATI (2789)
RIO VISTA (2641)
PINOLE (2547)
ROHNERT PARK (2534)
FAIRFIELD (2446)
PITTSBURG (2338)
SAN PABLO (2134)
NAPA (2968)
LIVERMORE (2833)
PETALUMA (2741)
CALISTOGA (2637)
DALY CITY (2541)
ANTIOCH (2506)
VACAVILLE (2392)
PACIFICA (2328)
2 DIXON (2042)

VALLEJO (1954)
CLOVERDALE (1634)
SUISUN (1994)
BRENTWOOD (1860)
1 YOUNTVILLE (1282)

* SCALE IN THOUSANDS OF DOLLARS

PER CAPITA SALES TAX REVENUES FOR BAY AREA CITIES*

1364.58 COLMA

200 EMERYVILLE (209.51)

100 BRISBANE (134.97)

90 BURLINGAME (94.10)

80 HEALDSBURG (80.97)

SAN LEANDRO (77.46)
SAUSALITO (78.57)
CAMPBELL (71.73)
70

S.S.F. (67.67)
SAN RAFAEL (64.88)
SEBASTOPOL (62.26)
MOUNTAIN VIEW (60.24)
RIO VISTA (68.23)
CORTE MADERA (65.62)
PALO ALTO (63.46)
SANTA CLARA (60.35)
60

SAN CARLOS (57.35)
WALNUT CREEK (55.75)
SANTA ROSA (51.28)
DIXON (50.15)
HERCULES (58.33)
CUPERTINO (56.90)
HAYWARD (53.73)
COTATI (50.70)
50

PLEASANT HILL (49.29)
MENLO PARK (48.37)
SAN MATEO (46.77)
CONCORD (44.08)
SONOMA (41.84)
EL CERRITO (41.54)
MILLBRAE (41.16)
ST. HELENA (40.36)
SAN PABLO (49.21)
SAN FRANCISCO (48.09)
REDWOOD CITY (44.98)
GILROY (42.29)
RICHMOND (41.77)
LOS GATOS (41.38)
VALLEJO (40.67)
40

SAN BRUNO (39.26)
SUNNYVALE (37.12)
ANTIOCH (32.59)
LAFAYETTE (31.49)
DALY CITY (30.84)
PETALUMA (39.46)
OAKLAND (38.17)
CLOVERDALE (35.81)
BRENTWOOD (32.52)
BERKELEY (30.84)
30

NAPA (29.43)
MORGAN HILL (29.15)
MILL VALLEY (26.74)
SUISUN (26.18)
LOS ALTOS (25.14)
BENICIA (23.78)
HALF MOON BAY (22.83)
NOVATO (21.53)
MILPITAS (20.70)
VACAVILLE (29.92)
SAN JOSE (29.34)
ALBANY (28.40)
FREMONT (26.29)
FAIRFIELD (26.03)
CALISTOGA (25.08)
SAN ANSELMO (23.44)
LARKSPUR (21.89)
UNION CITY (20.96)
20

NEWARK (19.59)
ALAMEDA (17.65)
LIVERMORE (17.58)
YOUNTVILLE (16.61)
PACIFICA (16.05)
PLEASANTON (15.09)
FOSTER CITY (13.82)
MORAGA (11.80)
WOODSIDE (10.59)
BELMONT (18.22)
MARTINEZ (17.67)
PINOLE (17.01)
PITTSBURG (16.33)
FAIRFAX (15.23)
ROHNERT PARK (14.05)
TIBURON (13.14)
CLAYTON (10.90)
10

BELVEDERE (7.23)
HILLSBOROUGH (4.35)
PIEDMONT (3.01)
ATHERTON (1.87)
SARATOGA (8.33)
ROSS (5.60)
PORTOLA VALLEY (4.32)
LOS ALTOS HILLS (2.54)
MONTE SERENO (.32)
0

* SCALE IN DOLLARS

PER CAPITA ASSESSED VALUATION FOR BAY AREA COUNTIES *

5 MARIN (5379)
SAN MATEO (4939)
CONTRA COSTA (4890)
SANTA CLARA (4285)
4 NAPA (4003)
ALAMEDA (3749)
SONOMA (3700)
3 SOLANO (3196)

*SCALE IN THOUSANDS OF DOLLARS

PER CAPITA SALES TAX REVENUES FOR BAY AREA COUNTIES*

NAPA (13.21)
10 SONOMA (12.57)
CONTRA COSTA (6.20)
SAN MATEO (5.51)
SANTA CLARA (4.57)
ALAMEDA (4.00)
MARIN (3.82)
SOLANO (2.08)
1

* SCALE IN DOLLARS

SOURCE: 1976-77 ASSESSED VALUATION, STATE CONTROLLER'S REPORTS OF FINANCIAL TRANSACTIONS CONCERNING CITIES AND COUNTIES, FISCAL YEAR 1975-76. DEPARTMENT OF FINANCE POPULATION ESTIMATES, JANUARY 1, 1976.

LOCAL GOVERNMENT FISCAL DISPARITIES IN THE BAY AREA

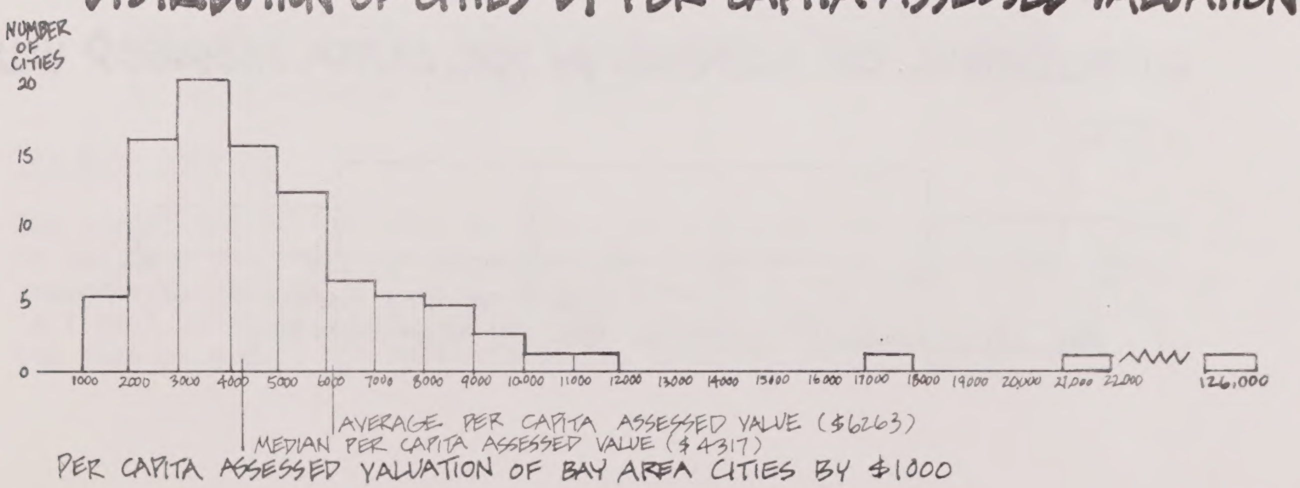
A "fiscal disparity" exists whenever two jurisdictions with equal tax rates produce different amounts of revenue. For example, two jurisdictions levying a $1.00 property tax may raise substantially different amounts of tax dollars because of differences in total assessed valuation. The two jurisdictions are said to have a fiscal disparity. In another case, a jurisdiction with a large shopping center may receive more sales tax revenue than a neighboring jurisdiction that has few commercial activities. Because such differences in the mix of residential and commercial or industrial development are inevitable, the present system of local government finance is characterized by substantial fiscal disparities.

"Metropolitan fiscal disparities" refers to the differences in fiscal capacities of local general purpose governments in a particular metropolitan region. The San Francisco Bay Area is such a region, and fiscal disparities exist among the region's cities and counties.

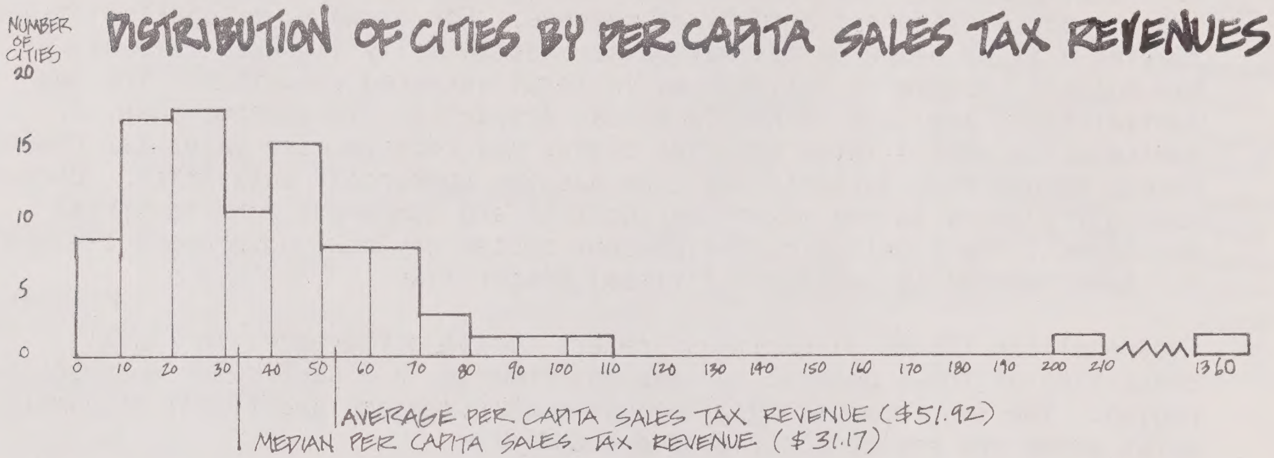
Using the State Controller's reports of financial transactions and the Department of Finance estimates of population, the average assessed valuation for the cities in the Bay Area is $6263. But the fiscal capacity for most of the region's cities are well below this average. Only 18 cities (20%) have per capita assessed valuations that are higher than the average, while 74 cities (80%) have less than average capacity to raise property tax revenues.

The chart below shows the distribution of the fiscal capacities of the 92 cities in the Bay Area. The per capita assessed value for the median cities (San Anselmo and Half Moon Bay) is almost $2,000 below the average.

DISTRIBUTION OF CITIES BY PER CAPITA ASSESSED VALUATION

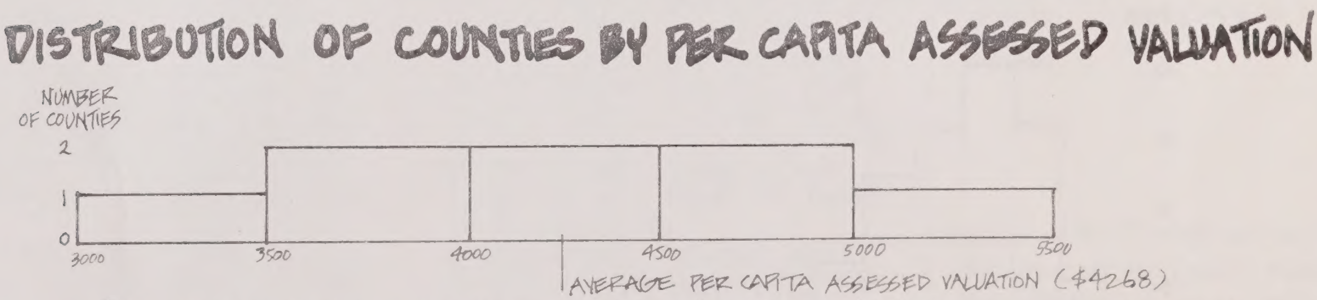


In the Bay Area, sales tax revenues range from $.32 per person in Monte Sereno to $1364.58 per person in Colma. The average per capita sales tax revenue is $51.92. But only 21 cities (23%) have revenues from sales taxes that are above this average. Three-fourths of the region's cities (71 jursidictions) have below average per capita revenues from sales taxes.



PER CAPITA SALES TAX REVENUES FOR BAY AREA CITIES BY $10

Bay Area counties have per capita assessed valuations that range from $5379 in Marin to $3196 in Solano. The average for the eight counties is $4268. Four of the region's counties have per capita assessed valuations that are above this average while four counties have below average fiscal capacity.



PER CAPITA ASSESSED VALUATION FOR BAY AREA COUNTIES

SOME APPROACHES FOR REDUCING FISCAL DISPARITIES

Bay Area jurisdictions depend heavily on locally generated property and sales tax revenues, and thus fiscal disparities cannot now be completely alleviated. In addition to the uneven distribution of tax bases noted in the previous section, the following phenomena contribute to local fiscal problems:

- Some jurisdictions "export" costs to other jurisdictions
  This can occur when a jurisdiction locates a shopping center, an airport or similar public facilities near its border, imposing service costs on surrounding jurisdictions (e.g., increased street maintenance because of larger than anticipated traffic volumes, or increased police services). Another example is a jurisdiction creating substantial employment opportunities without providing sufficient housing, forcing job holders to live elsewhere. School and other public service costs would be imposed on the neighboring communities.

- Some jurisdictions "capture" revenues from other jurisdictions
  A large shopping center--whether at the fringe of a community or as part of a downtown renewal project--may attract shoppers from surrounding jurisdictions and thus capture sales tax revenues that otherwise would have gone to those communities.

- Some jurisdictions provide special services to residents of other jurisdictions
  Examples of special services include the provision of zoos, museums or special recreational facilities such as beaches, parks, or libraries to residents of many jurisdictions. The revenues generated by such facilities do not always offset the cost to the local jurisdiction providing the special services.

- Some jurisdictions have wealthier populations than others
  Thus, it is relatively less difficult for these jurisdictions to raise revenues through taxes.

Tax Base Sharing

One direct method for reducing fiscal disparities in a metropolitan area is tax base sharing. Tax base sharing is designed to strengthen fiscal capacity to respond to public service demands by narrowing the disparities in fiscal capacity among jurisdictions in the same region. An areawide tax base plan does not necessitate the creation of an areawide authority.

In 1971 the Minnesota Legislature adopted a tax base sharing plan for the Minneapolis-St. Paul metropolitan region. The Minnesota system provides that 40% of future increases in commercial and industrial assessed valuation be combined in an areawide revenue pool. This revenue is redistributed to cities and counties in the metropolitan area on the basis of a formula that considers population, assessed valuation, income, expenditures and revenues, although population is the main determinant of allocation to the various jurisdictions. The legality of this system was upheld by the Minnesota Supreme Court in 1974.

The tax-sharing plan has reduced fiscal disparities somewhat in the Twin Cities region. Of the 38 municipalities (all with a population of more than 10,000) involved in the tax sharing plan, 20 were net "gainers"--that is, they received more revenues than they contributed to the tax pool). Eighteen were "losers." The losers accounted for approximately 25% of the population. They contributed about 53% of the total increase in assessed valuation, and received about 22% of that value from the distribution of the tax base.

Federal Revenue Sharing

Another method for addressing the serious fiscal problems facing local governments is through increasing Federal aid. Fiscal disparities can be reduced by the "targeting" of such aid based upon measures of "need."

The State and Local Fiscal Assistance Act of 1972 established the general revenue sharing program, which provides states and general purpose governments with revenues that can be spent according to local discretion.

Revenue entitlements under the act are based upon a set of formulas that consider per capita income among other factors. The program generally provides large cities with greater per capita grants than small cities. The formula could be altered to more explicitly address fiscal disparities by using a better measure of fiscal capacity than per capita income.

State Revenue Sharing

SB 90, to carry out its principle of reducing the "undue reliance on the property tax," provides for subvention from the State General Fund to local governments, which "...will serve to partially equalize tax burdens among all citizens." These revenues are provided as "replacement" for revenues lost to local governments by the repeal or reduction of property tax on some kinds of property. This principle could be extended to explicitly compensate for fiscal disparities by including State subventions to jurisdictions with low fiscal capacities.

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